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FISCAL IMPACT STATEMENT

LS 6346 | **NOTE PREPARED:** Jan 6, 2010
BILL NUMBER: SB 398 | **BILL AMENDED:**

SUBJECT: Homestead Property Taxes and Sales and Use Taxes.

FIRST AUTHOR: Sen. Young R Michael | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: **GENERAL** **DEDICATED** **FEDERAL** | **IMPACT:** State & Local

Summary of Legislation: *Homestead Property Taxes:* This bill eliminates property taxes on primary residences (homesteads). It eliminates the right of a governmental unit, including special benefit districts, to place a lien on a homestead.

Sales Tax: The bill decreases the State Sales and Use Tax rate from 7% to 5.5%. It provides that Sales and Use Tax applies to transactions involving services, except for legal services, health or mental health services (including insurance premiums for policies covering these services), and services provided for charitable tax exempt purposes.

Homestead Replacement Distributions: The bill deposits the increased Sales and Use Tax revenue in the state General Fund. It provides an annual state distribution to offset the property tax exemption for homesteads using gross assessed values of homesteads. It also reduces actual property tax levies by the amount of the state distribution.

LOIT: This bill reduces local option income tax rates by the part attributable to paying homestead credits, property tax replacement credits on homesteads, or freezing levy growth on homesteads unless the county adopts an ordinance to allocate the revenue to the general fund of the various civil taxing units in the county.

Renter's Deduction: The bill increases the maximum renter's deduction for income tax purposes from $3,000 to $8,000 per taxable year.

This bill also removes references to the homestead credit throughout the Indiana Code, removes superseded provisions, makes conforming changes, and makes an ongoing appropriation.

Effective Date: Upon passage; July 1, 2010; January 1, 2011.

Summary of NET State Impact: This bill would result in an overall net gain to the state estimated at $1,350 M in FY 2011 and $710 M in 2012.

Summary of State Impact In Millions		
	FY 2011	**FY 2012**
Revenue:		
Sales Tax	$2,328	$2,722
Renter's and Homeowners Deductions	--	($33)
Total Net Revenue	$2,328	$2,689
Expenses:		
Homestead Replacement	978	1,979
Net State Impact	**$1,350**	**$710**

Explanation of State Expenditures: *Department of State Revenue (DOR)*: This bill will result in an increase in administrative costs for the DOR by requiring the DOR to revise Sales Tax forms as well as update computer software. The increase is indeterminable and will depend on the amount of resources that will be required to incorporate the rate decrease and to collect the Sales Tax on services. It is estimated that the DOR will be able to implement the provisions of this bill with its existing level of resources.

Explanation of State Revenues: *Impact on Sales Tax Revenue*: This bill is estimated to increase Sales Tax revenue by $2,328.4 M in FY 2011 and $2,722 M in FY 2012. The amount for FY 2011 is adjusted for 11 months of collections due to the July 1, 2010, effective date of the bill. The estimates are based on the Revenue Technical Committee Forecast (December 15, 2009).

The bill provides that a Sales Tax of 5.5% shall be imposed on the sale of goods and services in Indiana. Currently, a Sales Tax rate of 7% is imposed on the sale of goods. By broadening the sales tax base to include services, the bill reduces the Sales Tax rate to 5.5%. The bill provides that legal services, medical services, and services provided for charitable tax-exempt purposes are exempt from Sales Tax. The table below shows the impact on funds currently included in the Sales Tax distribution formula.

	Revenue Impact (in millions)	
Fund	**FY 2011**	**FY 2012**
State General Fund	$2,317.90	$2,709.80
Public Mass Transportation Fund	$8.20	$9.60
Industrial Rail Service Fund	$0.40	$0.50
Commuter Rail Service Fund	$1.80	$2.10
Total	**$2,328.40**	**$2,722.00**

Under the bill, Sales Tax revenue would be deposited in the state General Fund (99.551%), the Public Mass Transportation Fund (0.353%), the Commuter Rail Service Fund (0.078%), and the Industrial Rail Service Fund (0.018%).

The bill also changes the retail merchant collection allowances received by retailers through the collection allowance. The table below shows the current allowance percentages and the new percentages under the bill.

Retailer's Sales Tax Collection Allowance		
Gross Sales Tax Liability	**Current %**	**New %**
Not more than $60,000	0.73%	0.93%
Greater than $60,000, not more than $600,000	0.53%	0.67%
Greater than $600,000	0.26%	0.33%

Impact on Income Tax Revenue: It is estimated that the bill could reduce revenue from the Individual Adjusted Gross Income (AGI) Tax by about $33.0 M in FY 2012. The net revenue loss is estimated to remain at that level in subsequent years. The bill impacts AGI tax revenue by: (1) increasing the maximum renter's deduction from $3,000 to $8,000; and (2) eliminating homestead property taxes and, as a result, eliminating the revenue loss from the homeowner's income tax deduction for property taxes. The table below summarizes the net impact.

	FY 2012
Increase in renter's deduction	($80.5)
Elimination of homeowner's income tax deduction for property taxes	47.5
Net Increase (Decrease) in millions	($33.0)

Background Information - *Renter's Deduction:* Under current statute, a taxpayer may deduct from taxable AGI up to $3,000 in rent paid during the taxable year by the taxpayer on his or her principal place of residence in Indiana. The bill increases the maximum deduction amount to $8,000 beginning in tax year 2011. (Note: The maximum deduction was increased from $2,500 to $3,000 effective in tax year 2008.) In 2007, 673,761 taxpayers deducted rent totaling approximately $1,556.9 M. The revenue loss estimate assumes that filers claiming the deduction will increase by about 1.4% per year. Estimates of deductible rent amounts under the increase are based on a population distribution of monthly rent payments developed from 2005-2007 housing rent data reported by the U.S. Census Bureau. Rent payments are projected beyond 2007 assuming a 2.4% annual inflation rate based on CPI for rent of primary residence reported by the U.S. Bureau of Labor Statistics.

Homeowner's Income Tax Deduction for Property Taxes: Under current statute, a taxpayer may deduct from taxable AGI up to $2,500 in property taxes paid during the taxable year in Indiana on his or her principal place of residence. Since the bill eliminates homestead property taxes beginning with Pay 2011 taxes, the revenue loss from this deduction would be eliminated beginning in tax year 2011. In 2007, about 1.4 million taxpayers deducted homestead property taxes totaling approximately $1,912.4 M. The revenue loss from the deduction thereafter is estimated based on simulations using tax data and estimated county growth rates for homestead property taxes.

Sales Tax revenue is currently deposited in the General Fund (99.178%), the Public Mass Transportation Fund (0.670%), the Commuter Rail Service Fund (0.123%), and the Industrial Rail Service Fund (0.029%). Revenue from the Individual AGI Tax is deposited in the state General Fund.

Explanation of Local Expenditures: *Homestead Property Taxes:* The elimination of homestead taxes under this bill would result in reduced expenses for processing and mailing property tax bills. There are just over 1.7 million homesteads statewide. Assuming $0.70 for processing and postage, the total statewide savings is estimated at $1.2 M.

Lake County Homestead Property Tax Credit: The bill eliminates this tax credit beginning in tax year 2011. Under current statute, the revenue loss from the tax credit must be reimbursed by Lake County, East Chicago, Gary, and Hammond. It is estimated that the savings to these local units could potentially total $7.0 M to $8.0 M per year.

Under current statute, the tax credit is available to homeowners in Lake County who have earned income of less than $18,600. A homeowner who has earned income of less than $18,000 is entitled to a credit equal to the lesser of $300 or the amount of property taxes paid on the qualified homestead. The tax credit phases out for homeowners with earned income between $18,000 and $18,600. For every dollar of income more than $18,000, the tax credit is reduced by $0.50 until the credit is $0 for homeowners with an earned income exceeding $18,600. In 2007, 23,517 taxpayers claimed about $6.9 M in tax credits. Annually, the cost of the tax credit is reimbursed from Riverboat Admission Tax revenue. Annually, Lake County reimburses 50% of the credit cost, with Gary, Hammond, and East Chicago each reimbursing 16.67% of the credit cost. The reimbursement is withheld from Riverboat Admission Tax revenue paid to these local units.

Explanation of Local Revenues: *Homestead Property Taxes:* Beginning in CY 2011 under this proposal, homestead property would be exempt from property taxation. The bill defines homestead property as a principal residence owned by the resident (or under contract), consisting of residential real property improvements, a mobile or manufactured home, and up to one acre of surrounding land. Under this definition, the entire homestead parcel (up to one acre of land) would be exempt. Under current law, a homestead includes only the dwelling plus up to one acre of land. Currently, total net homestead taxes after all currently adopted credits is estimated at $1.8 B in 2011.

Homestead Replacement Distributions: Beginning in CY 2011 under this proposal, the state would make distributions from the state General Fund to counties each year to replace homestead taxes. The amount distributed to each county in a year would equal (1) the net property tax that would otherwise have been due on homestead property in the previous year if deductions were left in place and the circuit breaker still applied, but without reducing the tax due for locally funded credits such as the LOIT credits or traditional county homestead credits, multiplied by (2) the income-based assessed value growth quotient (AVGQ). The Auditor of State would make the distributions in two equal installments on the first business days in May and November.

The 2010 net tax after circuit breaker credits attributable to homestead property is estimated at $1.75 B, the total amount of county credits in 2010 is estimated at $150 M, and the 2011 AVGQ is estimated at 2.9%. Using these estimates, the distribution to counties would amount to approximately $1.955 B in CY 2011. The 2012 distribution is estimated at $2.002 B and the 2013 distribution is estimated at $2.044 B.

Each taxing unit in the county would receive a pro rata share of the distribution based on the net tax that the unit would have otherwise received from homestead property. The taxing unit's maximum levy would be reduced by the allocation amount.

LOIT: This proposal would eliminate the use of traditional COIT and CEDIT revenues and the use of the new LOIT revenues to reduce homestead taxes. The State Budget Agency would calculate new CAGIT, COIT, and CEDIT tax rates for each county to adjust for the county credits currently granted to homestead owners. The new income tax rates would take effect on October 1, 2010. Local credits for homesteads are estimated at $150 M In 2010.

A county could, by ordinance, continue all or part of the income tax rate and distribute the proceeds to all taxing units in the county as though they were property tax revenue. Under current law, property tax collections that exceed 100% of a taxing unit's certified levy must be deposited into the unit's levy excess fund. Money in this fund may only be used to pay tax refunds and to reduce future tax levies.

Sales Tax: Local revenues would increase to the extent that a local unit receives funds from the Public Mass Transportation Fund, the Commuter Rail Service Fund, or the Industrial Rail Service Fund.

State Agencies Affected: Department of Local Government Finance; Auditor of State; State Budget Agency; DOR.

Local Agencies Affected: County auditors; County treasurers; All civil taxing units and school corporations; Lake County, East Chicago, Gary, and Hammond.

Information Sources: Revenue Technical Committee Forecast (December 15, 2009); OFMA Income Tax databases 1996-2007. U.S. Census Bureau, *2005-2007 American Community Survey*, contract rent statistics; U.S. Bureau of Labor Statistics, Consumer Price Index, Midwest Urban Consumers, Rent of Primary Residence; OFMA Property Tax Databases.

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